BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 96-168-W/S - ORDER NO. 97-151

FEBRUARY 26, 1997

IN RE: Application of Kiawah Island Utility, Inc. for Approval of an Increase in its Rates and Charges for Water and Sewer Services.	))))	ORDER DENYING PETITIONS FOR REHEARING AND/OR RECONSIDERATION

This matter comes before the Public Service Commission of South Carolina (the Commission) on the Petitions for Rehearing and/or Reconsideration of Order No. 97-4 filed by the Consumer Advocate for the State of South Carolina (the Consumer Advocate) and the Kiawah Property Owners Group (KPOG). Because of the reasoning stated below, the two Petitions must be denied.

First, the Consumer Advocate objects to the Commission's treatment in Order No. 97-4 of customer growth. The Consumer Advocate states that a finding contained therein on page 20 is in direct conflict with the Commission's finding two weeks earlier in Order No. 96-879, issued in Docket No. 96-137-W/S for Tega Cay Water Service, Inc. (Tega Cay). In the case at bar, the Commission rejected the Consumer Advocate's proposed customer growth adjustment. The Consumer Advocate's adjustment was accepted in the Tega Cay case. According to the Consumer Advocate, the Commission has given no explanation of its change, and, therefore, the Commission's decision in Order No. 97-4 is

arbitrary, capricious, and an abuse of discretion in violation of S. C. Code Ann. Section 1-23-380 (A)(6).

The case of Concord Street Neighborhood Association v. Campson, 309 S.C. 514, 424 S.E.2d 538 (1992) is instructive. Among other principles, the case espouses that an administrative agency is generally not bound by the principle of stare decisis, but it cannot act arbitrarily in failing to follow established precedent. That case went on to recognize, however, that distinguishing factors existed between it and another case, and therefore, the Court in the Concord Street Neighborhood Association case did not necessarily have to follow the tenets of the other case.

In the present case, the Commission would note that in Tega Cay, Order No. 96-879, the Commission specifically stated that, for that proceeding, the Commission believed that the method proposed by the Consumer Advocate was a better one by which to calculate customer growth. The Commission recognized in that Order that the customer growth adjustment proposed by the Consumer Advocate was more "aggressive," and was appropriate, given the testimony in that case. In the Tega Cay case, there was testimony from the Mayor of Tega Cay concerning the growth of Tega Cay, which the Commission believed justified the use of the Consumer Advocate's more "aggressive" customer growth adjustment.

In the present case, no such testimony was presented. Therefore, we clearly saw no reason to adopt the more "aggressive" method proposed by the Consumer Advocate, since no comparable

testimony as was given in the Tega Cay case was presented here. The Commission's decision was therefore not arbitrary, but was based on differing factors between the two cases. We therefore believe that our decision on customer growth in this case was correct and lawful, and that the Consumer Advocate's allegation regarding customer growth is without merit.

Second, the Consumer Advocate takes issue with the Order of the Commission with regard to the cash working capital adjustment. The Consumer Advocate states that the Commission's Order No. 97-4 on the subject violated S. C. Code Ann. Section 1-23-350 (1986), because the Commission allegedly failed to make actual findings of fact.

Further, the Consumer Advocate states that by not considering the property tax and income tax factors set forth in Consumer Advocate witness Miller's testimony, the Commission somehow determined a cash working capital requirement which only considered one-half (½) of the cash working capital equation, and which somehow increases cash working capital. According to the Consumer Advocate, this is improper, and the calculation must somehow be modified to consider the portion which decreases the cash working capital as a result of revenues being collected before taxes have to be paid.

We have re-examined this, and other allegations concerning the Commission's holding on cash working capital in Order No. 97-4, and believe that they must be rejected. Consumer Advocate witness Miller stated that the lead-lag study is normally regarded

as the most accurate method of determining cash working capital requirements. See Testimony of Miller at 29, lines 7-8. He further states that "however, for utilities with smaller cash working capital requirements, cash working capital is often determined on the basis of a formula method." See Miller at 29, lines 17-18. The Commission agrees with the latter statement. In fact, we are of the opinion that no water and sewer utility operating under our jurisdiction warrants setting its cash working capital allowance based on the lead-lag study, which would be an additional expense to the utility for a time consuming study that, in our opinion, yields disputable results.

Further, Staff witness Maready testified that some of the property taxes are paid on a monthly basis, such as on equipment, and are registered separately on the property records of the County. These expenses would affect the cash working capital allowance the same as any other expense, such as wages. However, only the balance of the taxes, that is, those that are paid on an annual basis, would be subject to a lead-lag study. We are unable to ascertain the separate tax amounts that would be subject to the lead-lag study.

Further, we are not convinced that cash working capital allowance should be a combination of accounts i.e., some based on a formula method, and other accounts based on a different method, since some of the accounts mentioned by the Consumer Advocate are merely the result of a balance sheet approach. Each of the accounts are estimated each month and accrued, and in some

instances, the estimated amounts are paid throughout the year. Since the accounts do appear on the balance sheet, then, the Consumer Advocate proposes that the Commission apply the lead-lag study to these accounts. The income statement, after approved adjustments for the test year ending December 31, 1995, shows a loss, and therefore, no income taxes. In fact, there will be no income taxes, until after the new rates have gone in effect, which will be in 1997, and even then, it is not a guarantee that the Company will have taxable income at that time. Thus, the Consumer Advocate's approach in this case is not appropriate.

In this case, the decision on revenue requirements was based on operating margin, as opposed to a return on rate base, the latter requiring the computation of a rate base. Cash working capital allowance is an element of the rate base. Rate base was not needed in this case, except to determine annualized interest and the income tax effect thereof. Any changes to cash working capital would not materially effect the operating margin in any case. In view of these issues concerning cash working capital, we believe that the Staff's proposal was the correct one, and that the Consumer Advocate's allegations are without merit.

Both the Consumer Advocate and KPOG take issue with the Commission's Order No. 97-4 with regard to tap fees (a.ka. "tap-in fees"). The Consumer Advocate states that the Commission's decision was erroneous, since, if the Company is not bearing the cost of the taps, then it should not be collecting a tap fee in the first place. Further, the Consumer Advocate states that, even

if the Company has not capitalized a tap cost, the revenue should still be subtracted from rate base in recognition of the cost-free status to the Company. Further, the Consumer Advocate states that if non-investor sources of funds are not used to offset rate base, then the investors will earn a return on rate base that is not fully supported with their investments, and that Order No. 97-4 sanctions such a situation.

KPOG states that the Commission disregarded the evidence before it, and that the majority of costs relating to tap-in fees are indeed included in the Company's assets, with some small exception. KPOG states that the Commission should include tap in fees for the test year of $122,500, since it needs to account for all tap fees in order to have an accurate financial structure to establish an operating margin for the utility.

We have examined this matter, and do not believe that either the Consumer Advocate's, or KPOG's allegations are meritorious. First, clearly, since no assets are included on the books with regard to tap fees, no subtraction from rate base as a contribution in aid of construction is appropriate. This is simply recognition of the matching principle. Further, more funds in this situation were contributed by the developer than by the ratepayer in the form of fees. We would note that there is nothing in the rules or chart of accounts about a company contributing such fees. Therefore, a tap fee may not necessarily be an asset on the books of the Company. If a tap fee is not an asset of the Company, then it does not need to be an off setting

entry in contributions in aid of construction. We note, however, that $122,500 was in revenues, and this was subtracted from revenues and added to the rate base as a contribution in aid of construction, which is the way we have handled this matter in prior Orders in this case. We believe that this approach is appropriate in the present case as well, due to the contributed tap fees to this utility.

Next, KPOG states that the Commission failed to account for building incentive fees or availability fees in the Order, and that this is inconsistent with prior Commission Orders in this case. According to KPOG, failure to account for these fees resulted in the ratepayers being required to underwrite various up-front costs to the utility company for areas being developed by the developer. According to KPOG, the utility must make an affirmative showing of the reasonableness of this transaction.

First, we would note that, with regard to building incentive fees, we do not note any evidence in the record to show that such fees were being collected during the test year. Second, we would note that, with regard to availability fees, $1.6 million was deducted from the rate base. See Hearing Exhibit 7, Adjustment No. 16, Exhibit A, p. 4. This is the gross amount. This appropriately recognizes availability fees, and in our opinion, is all that is necessary to do so. Therefore, KPOG's availability fee allegations are without merit.

Next, KPOG alleges that the Commission failed to address and/or account for unidentified assets charged to the utility in

1991 by the developer. KPOG objects to the ratepayers paying the interest expense on the loan associated with these assets, and other matters related thereto. According to KPOG, the Commission should have denied all expenses related to the unidentified assets.

First, it should be noted that, if a company cannot recognize certain assets, it cannot keep them on the books. Therefore, the Company deducted $445,000 from water assets, and $445,000 from sewer assets, in an attempt to recognize the value of the unidentified assets as much as possible, and remove them from the books. This methodology was approved in Order No. 92-1030, and is likewise appropriate in the present case as well, since the present case presents similar circumstances with regard to unidentified assets as the last case. Further, with regard to potential inconsistency with the Uniform System of Accounts, it should be noted that the Commission can deviate from the System, when appropriate, by Commission Order. See Hamm v. South Carolina Public Service Commission, 294 S.C. 320, 364 S.E.2d 455 (1988).

With regard to the question of fire hydrants, KPOG states that the utility was allowed to claim expenses for fire hydrant purchases that are uniformly absorbed by other developers. We should note that there is nothing in the Chart of Accounts nor any rule requiring a company to contribute fire hydrants. Therefore, we of this Commission believe that the claiming of expenses for the fire hydrants in this case was appropriate as a known and measurable expense, and we reject KPOG's adjustments.

We also reject KPOG's allegations with regard to land leases, and the Down Island Storage facility. In our Order No. 97-4, we admonished Kiawah Island Utility, Inc. for not having the land lease contracts approved by the Commission, and cautioned the Company to do so, should such contracts arise in the future. However, we found the expenses to be reasonable, even so, and we still believe that said expenses are reasonable.

With regard to the Down Island storage facility, we would note that there is no cost in the operating and maintenance expenses for the test year. A payment on this facility was not made until after the test year, but the Commission kept the asset in as a known and measurable post-test year adjustment.

KPOG also objected to the Commission's transmission versus distribution cost allocations. We believe that the issue was not the definition of a distribution line, as was alleged by KPOG's witnesses. Any differentiation between transmission and distribution was irrelevant, given the Commission's approach in this case.

With regard to the Wastewater Treatment Cell No. 2 expenses, KPOG objected to the Commission allowing expenses of approximately $350,000. KPOG argues that these were not proper expenses for ratemaking purposes, since this was a holding pond for effluent only. We, however, believe that this was used and useful equipment, and that the expenses claimed therefrom are appropriate. Therefore, the expenses were proper. We reject KPOG's assertions.

Finally, KPOG states that the Commission allowed the parent corporation to cross-collateralize and provide for cross-default provisions, should the parent corporation fail to meet its loan payments.

We must state that in this situation, we do not believe that the utility can easily obtain capital as a separate entity, but we believe that the utility may be forced to tie in with its parent company in order to obtain appropriate financing. We therefore believe that the transactions between the parent and the utility were appropriate in this case. However, we further order Staff to monitor such affiliate transactions in the future, and require the utility to take such steps as may be required to ensure independent financial viability as much as possible.

Because of the above-stated reasoning, we hereby hold that the Petitions for Rehearing and/or Reconsideration of Order No. 97-4 are denied.

This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

Chairman

ATTEST:

Executive Director

(SEAL)